MP McShane Partners

April 2021 INSIGHTS

Investment Overview

Revisiting the Rotation

In the December 2020 edition of INSIGHTS, the Investment Team alluded to the risk of a significant rotation out of the Information Technology sector, and this scenario has rapidly materialized, necessitating an earlier-than-anticipated update on the wave of this rapid rotation in the market.

Cautious to Capitulation in Record Time

Immediately after the 2020 U.S. presidential election, preliminary indications of an early-stage shift or short-term rotation into much-maligned *cyclical sectors*, although most asset managers and institutional investors were initially skeptical to acknowledge or accept these signals after several years of dominant outperformance by Information Technology and other *high-growth*, *momentum-driven sectors*. Over the past ±5-10 years, most investors have been reluctant to own or hold anything exhibiting short-term relative underperformance, regardless of their *underlying fundamentals* or *intrinsic values* and relative appeal to *valuation-sensitive* investment managers, and any argument defending the inexpensive valuations of these underperformers or beleaguered *economically-sensitive*, *pro-cyclical sectors* was met with skepticism and suspicion by investors.

Many believe the stock market to be *perfectly efficient*, but incidences of exaggerated swings due to extreme euphoria or acute despair speak to *inherent inefficiencies* that often represent attractive opportunities for astute long-term

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Wealth Advisory Overview

Spring Clean Your Finances

When the weather turns warm you might find yourself daydreaming about sunny days at the beach and whether or not you can afford to retire.

The following tips can help you clean up your finances while you get the rest of your house in order.

Review Your List of Planned Expenses

Is your monthly budget still realistic? Have you experienced changes in spending habits either upward or downward? When creating your plan, it is critical to have a good understanding of how much money you need to maintain the lifestyle you want. How did your spending and priorities change during the last year? For many of us, it gave us a glimpse into what brings you satisfaction or what you missed. This might be a good time to do a budget review.

For big ticket items have you written down your goals and timing to accomplish them? Have you adequately considered college funding? Planned for downsizing/rightsizing of your home? If you are married, are your goals and expectations in line with your spouse's? You may want to have a discussion of expected retirement timeframes and whether or not you want to significantly alter your current lifestyle after you stop working.

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Points of Interest

- Monthly Index Review
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Revisiting the Rotation

investors. While information may be *more efficient* today, *behavioral biases* are as pronounced, predictable, and exploitable as they have ever been.

Accelerated Schedule

Despite the obviously superior positioning of the Information Technology sector throughout much of 2020, market participants failed to appreciate the degree to which *momentum* had driven *valuations* and *market capitalizations* ("market caps") to *relative extremes* at the expense of the rest of the market. At such extremes, investors and their portfolios were positioned as if Information Technology stocks were the <u>only</u> assets capable of generating attractive investment returns, regardless of their respective contribution to economic growth relative to other sectors or industries. It is important to remember, however, that even the most flawlessly positioned or well-capitalized company can become *overpriced* at some point, and the *return to parity* can be particularly painful for a portfolio with unilateral positioning in or *concentrated exposures* to a singular investment theme, economic sector, or individual stock.

The recent reversal of the *high-growth*, *momentum-driven* trades that outperformed throughout 2020 highlights the *downside perils* of *concentrated positioning* skewing portfolio-level *risk-return exposures*. **Consequently, many investors have been left reeling after *cautionary warnings* escalated into *full-fledged capitulation* in *less than* five months, with the Information Technology sector returning +17.62% since Election Day (i.e., Nov. 3rd 2020) vs. a comparable return of +69.99% for the Energy sector.** As market participants were quick to learn during the precipitous pandemic-induced bear market correction at the end of the first quarter of 2020 ("1Q20"), equity markets are responding to headline risks *more quickly* and *more violently* than ever before, and the resultant rotations appear increasingly *reactive*, *rash*, and *mercurial*, lacking any meaningful or methodical consideration of underlying fundamentals.

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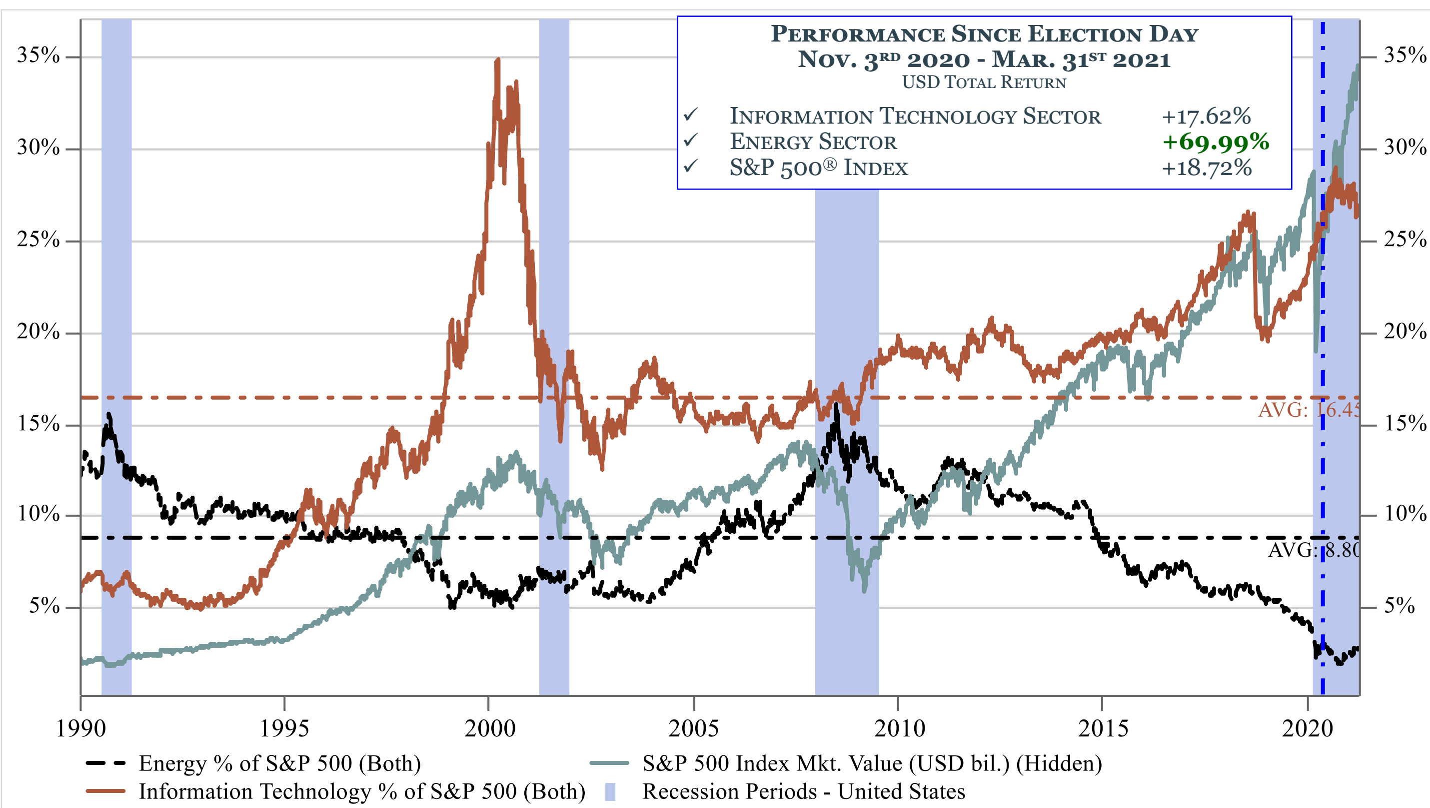
Chart I: GICS® Sector Market Capitalization as % of S&P 500® Index



Source: McShane Partners - FactSet Research Systems, Inc.

Investment Overview

Revisiting the Rotation

Rationalizing Responsibility for the Rotation

As analysts, economists, and financial media pundits have clamored to speculate on the catalyst for the recent rotation, *interest rates* and *inflation* are invariable identified as the culprits. To understand the traditional relationship between *interest-rate sensitive* assets, including certain stock market sectors and industries, the Investment Team has summarized the high-level impact of these interest rate dynamics across several financial markets and asset classes in Table I, below. Of particular significance is the relationship between interest rates and **Long-Duration/Speculative Stocks**, which provides some much-needed context for the noticeable decline in and relative underperformance of the Information Technology sector year-to-date ("YTD") in 2021.

Table I: Interest Rate Implications

Interest Rates	Bond Prices	U.S. Dollar ("USD")	Emerging Markets Equities	Long-Duration/ Speculative Stocks
⇧	⇩	⇧	⇩	⇩
⇩	⇧	⇩	⇧	⇧

Source: McShane Partners

"Those people who are imaginative see many more dangers than perhaps exist, certainly many more than will happen; but then they must also pray to be given that extra courage to carry this far-reaching imagination."

- Sir Winston Churchill

While ascribing a culprit for the short-term sell-off in Information Technology stocks may be an interesting and intellectually stimulating exercise, it offers little in terms of guidance for enhancing portfolio-level positioning, counsel for improving portfolio management processes, or parameters for planning future investment decisions and recommendations. A lesson worth learning, however, is that *every* financial asset carries an *inherent investment risk* of becoming *expensive*, *overpriced*, and *overowned* at some point, and the market's fundamental functionality as a *mean-reverting mechanism* will ultimately correct *egregious mispricings*.

In light of this, the Investment Team believes the following takeaways should be applicable to every investor, regardless of risk tolerance or investment philosophy:

1. Certain sectors and individual stocks have been driven to *illogical, unreasonable prices* by *irrational enthusiasm* and *momentum-based trading strategies*; while some financial assets are *more prone* to inducing *herding behavior*, few investments are immune to the associated risks.
2. Eventually, a markets' *supply-demand dynamics* act as a *mean-reverting mechanism*, correcting *mispricings* in *overpriced/(underpriced) assets*.
3. Finding and identifying the *catalyst* or *culprit* behind a recent correction in a particular asset is typically an exercise in looking out of the *rearview mirror*; while it *may* be *intellectually stimulating*, it does *not* provide *forward-looking guidance* or *recommendations* for profitable investment trends, trades, or strategies.

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4. *Proper portfolio construction* should *anticipate* multiple scenarios and avoid reacting to unfavorable market cyclicality; as such, long-term investment portfolios should comprise a carefully crafted combination of *risk-return exposures*, including allocations to *in-favor momentum stocks* with *long-term secular growth stories* and *out-of-favor, inexpensive stocks of high-quality companies* offering *attractive downside protection* and *relative price appreciation* when the market's mean-reverting mechanism inevitably precipitates severe corrections in the prices and market values of those *overpriced, overowned assets.*

Monthly Index Review
USD Total Return

Data as of March 31st 2021	March 2021	2021 YTD	2020	2019
S&P 500® Index	**+4.38%**	+6.17%	+18.40%	**+31.49%**
Dow Jones Industrial Average	**+6.78%**	**+8.29%**	+9.72%	+25.34%
NASDAQ Composite	+0.48%	+2.95%	**+44.92%**	**+36.69%**
Russell 2000	+1.00%	**+12.70%**	**+19.96%**	+25.52%
MSCI Emerging Markets	**-1.49%**	+2.34%	+18.69%	+18.88%
MSCI EAFE	+2.40%	+3.60%	+8.28%	+22.66%
Bloomberg Barclays U.S. Aggregate Bond Index	**-1.25%**	**-3.37%**	+7.51%	+8.72%

Stock & Strategy Spotlight

Name	Ticker	March 2021	2021 YTD
Electronic Arts, Inc.	EA	+1.17%	-5.16%

Description & Investment Thesis

Earlier this month, the Investment Team initiated coverage on shares of Electronic Arts, Inc. ("EA"), adding the stock to applicable firm-wide buy lists and security-level models, including our high-conviction, concentrated equity portfolio strategy: the McShane Partners Core Contrarian Equity Portfolio Strategy ("the Strategy"). While shares of EA have not been immune to the recent rotation out of growth-oriented stocks, including short-term pullbacks or corrections in several of the *stay-at-home/work-from-home* ("SAH/WFH") trades that outperformed throughout 2020, the Investment Team believes that the *long-term secular growth drivers* for the company's primary businesses remain intact. In September 2019, the Investment Team came to a similar conclusion regarding the *long-term outlook* and *attractive risk-adjusted return potential* for shares of Activision Blizzard, Inc. ("ATVI"), especially given the relative upside scenario heading into the year-end holiday season. Despite having underperformed throughout much of 2019, shares of ATVI rallied into year-end, outperforming the S&P 500® Index by **±450 basis points** ("bps") through the final four months of 2019. Shares of ATVI were a significant beneficiary of the SAH/WFH trades in 2020, as well, returning a staggering **+59.34%** for the year and outperforming the S&P 500® Index by **±4,194 bps**. To that end, the Investment Team believes that shares of EA are trading at *incrementally attractive relative valuations* compared to shares of ATVI but continues to believe in the *long-term secular theme* of *increased adoption* of *interactive, at-home entertainment* offerings driving above-average growth for the industry, which is why we will be *actively initiating new positions* in EA, while also *maintaining existing positions* in ATVI for the time being.

Wealth Advisory Overview

Spring Clean Your Finances

Review Your Current Status

Have you been able to create and maintain an emergency account of liquid assets? We generally recommend having 18-24 months of cash on hand for emergencies and near-term cash flow needs. If you have quantified and set that money aside, do you have an excess or shortfall that you may want to address, by either deploying money into investments or accumulating more cash?

Are you able to save or invest more? Now that we are 3 months into 2020, you may be experiencing a higher degree of security regarding your salary and/or bonus levels. If you have not increased your savings rate in a while, now might be a good time to do so. The best time to increase savings rates are generally following a salary increase or a bonus payout.

With interest rates continuing to sit at historic lows, consider refinancing debt if you have not done so already. Although many advisors recommend paying down debt, at current interest rates it may not necessarily be beneficial to do so. Tax deductible interest expense is one of the few remaining tax deductions for individuals. Review any debt you have and be tactical about how and when you pay debts off.

Consolidate Random Assets

Although not as common, you may have accounts at various institutions with minimal balances. These may include stock grants or retirement plans from previous employers. It may be inherited assets or that defunct investment club. Often a smaller account can get neglected. At best it may not be optimized for your overall investment strategy. At worst you may forget about it entirely following moves and job changes, allowing the accounts to become escheat (unclaimed property). If your previous employers experienced acquisitions or corporate changes, make sure your old deferred compensation plans can find you.

Consider your Tax Status

When your tax return is finalized this year, determine your marginal tax bracket. Your marginal bracket applies to the last dollar of income earned. As your income increases, it gets taxed at progressively higher rates. You may be just over a bracket, or squarely in the middle. Your earned income may push your long-term capital gains into a higher tax bracket, or a reduction in your earnings may have had the opposite effect. Tax planning is not a one-size fits all, or a static exercise. It may change during a “gap period”, when you are no longer drawing a salary but have yet to tap into tax deferred accounts or social security. Or you may be moving upward in your career and foresee earned income continuing for a longer period.

Review Your Need for Insurance

If you have previously determined a need for insurance, have you reviewed those policies lately? As you age and your family dynamics change, the needs for the type and amount of insurance can change substantially. You may have a net worth that has eliminated the need for certain types of insurance, or you may need to consider long term care policies.

Spring cleaning is an important annual exercise, both for your home as well as your finances. At McShane Partners, we are always willing to help you with your financial spring cleaning either now or during your annual review. Let us know how we can help!

Tax Update: 2020 Extension Granted

Becky Hoover
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The Treasury Department and Internal Revenue Service announced on March 17th that the federal income tax filing due date for individuals for the 2020 tax year will be automatically extended from April 15, 2021, to May 17, 2021.

Individual taxpayers can also postpone federal income tax payments for the 2020 tax year due on April 15, 2021, to May 17, 2021, without penalties and interest, regardless of the amount owed. This postponement applies to individual taxpayers, including individuals who pay self-employment tax. Individual taxpayers will automatically avoid interest and penalties on the taxes paid by May 17.

Individual taxpayers do not need to file any forms or call the IRS to qualify for this automatic federal tax filing and payment relief.

This relief does not apply to estimated tax payments that are due on April 15, 2021. These payments are still due on April 15.

North Carolina has announced an extension of time to May 17, 2021 to mirror the federal extension. We will keep you updated as additional guidance is provided.

Senior Planning: What is the Best Age to Collect Social Security Benefits?

Lorri Tomlin, FPQP™
Wealth Advisor

If you were born in 1943 or after, your full retirement age (FRA) is somewhere between 66 and 67. However, you can start collecting your Social Security benefit as early as age 62 or as late as age 70 but your monthly benefit amount will vary depending on the age you choose. Your estimated benefit will be permanently reduced if you start taking it earlier than your FRA and it will be increased if you wait to take it later.

There Are a Few Things You Need to Consider if You Want to Start Collecting Benefits at Age 62:

Do You Have Enough Credits?

You must contribute to Social Security while you are working to earn benefits. To receive your full benefit, you must have 40 credits. Depending on your income, you earn 1-4 credits each year that you work. For example, in 2021 the minimum income needed to earn 4 credits is $5,880. You would need 10 years of earning the minimum amount to get 4 credits each of those years to qualify for full Social Security benefits. If you do not have enough credits, you may need to work a few more years.

Do You Want/Need to Continue Working After You Start Collecting Social Security?

If you start taking Social Security benefits at the earliest age possible, 62, you can still work but your benefits could be reduced if your earnings are too high. If your income is above the annual income threshold ($18,960 for 2021), Social Security will withhold $1 for every $2 you earn above the threshold. If you were counting on the entire estimated benefit (albeit reduced from your full retirement benefit) you may be very disappointed. Once you reach your FRA, your benefits will be recalculated, and you will be refunded the withheld amount. However, if you can wait until your full retirement age to start receiving your benefits, you may continue to work and collect your benefits without penalty regardless of earnings.

Finally, Is the Permanently Reduced Benefit Sufficient for Your Retirement Needs?

If you start collecting benefits at age 62, your benefit amount will be reduced by as much as 30% for the rest of your life. If you anticipate a shorter lifespan, taking your benefits early will provide you with more time to enjoy your money even if you are receiving a smaller amount. The question is, will this reduced amount provide enough income for you in retirement?

Next month we will look at taking benefits at Full Retirement age and delaying benefits until age 70. As always, your Wealth Advisor is here to assist you in making this important decision so please let us know how we can help.

Finance Corner: When Should I Refinance My Mortgage?

Sandy Carlson
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President & Partner | Wealth Advisor

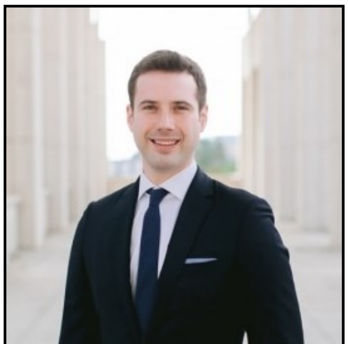
With interest rates at record lows, we are often asked whether it makes sense to refinance an existing mortgage. Refinancing includes paying off your existing loan with a new one. Refinance costs include obtaining an appraisal, title search and various fees charged by both the title company, as well as the lender.

Reasons to refinance include:

- To obtain a lower interest rate
- To shorten the term of an existing mortgage
- To convert from an adjustable-rate mortgage (ARM) to a fixed rate mortgage
- To tap into home your home's equity

One of the main reasons individuals refinance an existing mortgage is to reduce the interest rate. Since there are costs associated with obtaining a new loan, it is important to understand when refinancing makes sense for your individual situation. The standard rule of thumb is that refinancing makes sense when you can reduce your interest rate by at least 1-2%. For example, if your existing mortgage rate is 4.75% and current rates are 3.375%, refinancing would reduce your interest rate by 1.375%; on a $415,000 mortgage, this would reduce your monthly payment by $330. If the cost to refinance is $4,620, your break-even point is 14 months, making the decision to refinance an easy one. Please let us know if we can help you access whether refinancing is right for you.

NextGen: What is Your Risk Tolerance and Why is it Important?



Ryan Vaudrin, CFP®
Wealth Advisor

Risk tolerance is the level of volatility that an investor is comfortable with within their investment portfolio. This tolerance can be gauged by various factors and it is extremely important to make sure that it matches an investors capacity for risk. If the wrong allocation has been selected, investors may find themselves invested inappropriately during volatile times.

October 2007 to March 2009 saw equities decline more than 50% and this decline was followed by the longest Bull market increase in history. Investors with improper asset allocations may have experienced more fluctuations than they could stomach, which could potentially result in rash decision making. To prevent hasty decisions, we help our clients navigate a risk tolerance questionnaire so that we can establish a guide for suitable recommendations.

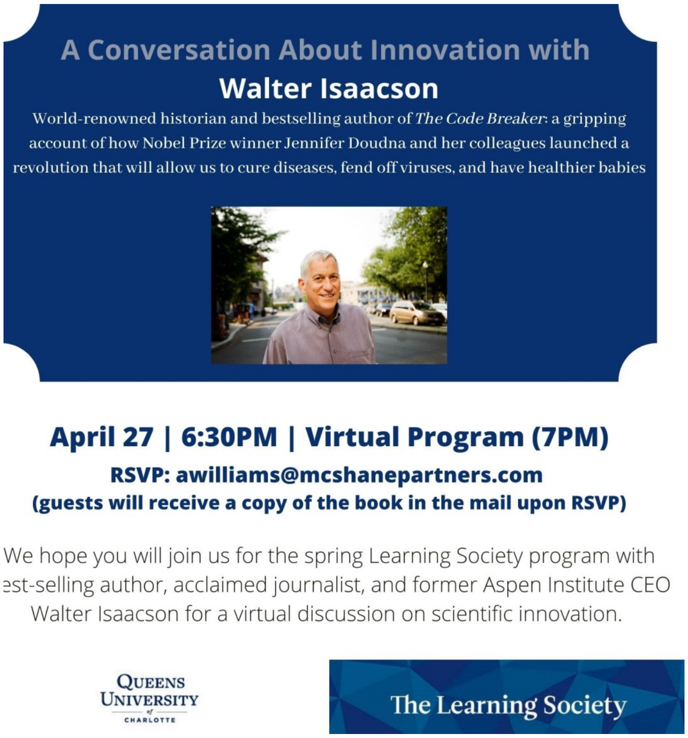
The risk tolerance questionnaire allows individuals to answer questions before making any investment decisions such as: *What is your investment knowledge? What are your primary goals and time horizon for your investments? What is your attitude toward investment risk in your portfolio?* In addition to these questions, a few investment scenarios are included to highlight the behavioral aspects of investing. These scenarios are designed to mentally stress test personal investment portfolios for potentially volatile years ahead.

Risk tolerance is often correlated to an investor's age since younger investors often have a longer investment time horizon. This longer time horizon provides a greater length of time for portfolios to recover from losses. As investors age, risk tolerance typically moves towards more conservative allocations to provide for less volatility and more stable returns. However, age is only one component when looking at risk tolerance: short term cash needs, income, and personal comfort levels are also important pieces that can influence decisions regarding investments.

At McShane Partners, we review these questions and scenarios diligently with investors to help mitigate unwanted fluctuations. It is important that a client's risk tolerance is understood so that the corresponding investment portfolio can be setup to mitigate volatility in the future, as well as be aligned with the client's expectations and comfort levels.

Around McShane Partners

Learning Society

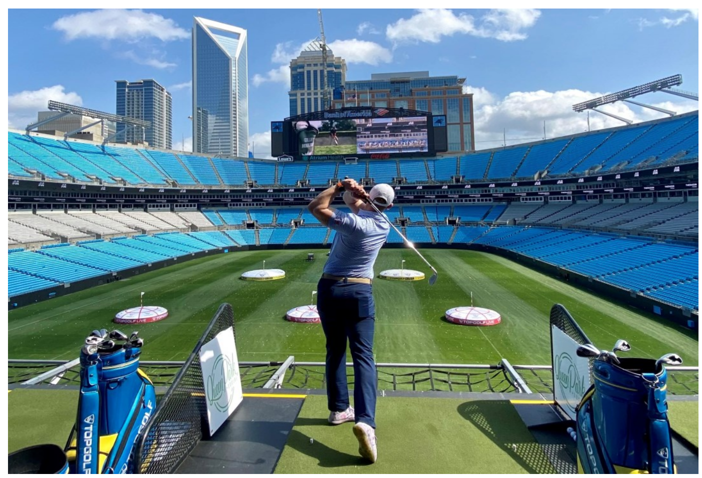


One of the main pillars of McShane Partners philanthropic giving is education. Daniele serves on the Executive Committee for the Queen's University Learning Society designed to bring innovative, intriguing speakers and authors to Charlotte. McShane Partners is the lead sponsor for this Spring's event featuring Walter Isaacson and a discussion of his recent book *The Code Breaker* a gripping account of how Noble Prize winner Jennifer Doudna launched a revolution that will allow us to cure diseases and fend off viruses. Her participation in the Coronavirus testing and vaccine formation is also timely and outlined in the book. If you would like to join us for the virtual program, please RSVP to awilliams@mcshanepartners.com and we will send you a copy of the book in advance of the event on April 27th at 6:30.

Pop Up Opera

We are "Popping"! McShane Partners is sponsoring the Pop-Up Opera for the second season. Please let us know if you are interested in joining us for our next outside Opera event for the entire family.

Top Golf Live



Elliott Van Ness enjoys a beautiful afternoon of "Top Golf Live" which was recently hosted at Bank of America Stadium.

McShane Partners

Wealth management is our only business; therefore, our attention is undivided, and our intentions are transparent.

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